Office of Chief Counsel
Internal Revenue Service

memorandum

CC:NER:PEN:PIT:TL-N-2403-99
EJLaubach

date: JUL 19 1999

to: Rick Palamara
Group Manager, Group 1704

from: Associate District Counsel, Pennsylvania District, Pittsburgh

subject: Abandonment Loss on [redacted] Goodwill
Re: [redacted]

THIS DOCUMENT MAY CONTAIN TAXPAYER INFORMATION SUBJECT TO SECTION 6103. THIS DOCUMENT MAY ALSO CONTAIN CONFIDENTIAL INFORMATION SUBJECT TO THE ATTORNEY-CLIENT AND DELIBERATIVE PROCESS PRIVILEGES AND MAY ALSO HAVE BEEN PREPARED IN ANTICIPATION OF LITIGATION. THEREFORE, THIS DOCUMENT SHALL NOT BE DISCLOSED TO TAXPAYERS OR THEIR REPRESENTATIVES OR DISCLOSED OR CIRCULATED BEYOND OFFICE PERSONNEL HAVING THE REQUISITE "NEED TO KNOW."

You have asked our office:

ISSUE

Whether [redacted] is entitled to claim an abandonment loss for goodwill acquired in [redacted] from [redacted] and [redacted], [redacted], and [redacted] when [redacted] closed the [redacted] operations during the taxable year ended [redacted].

CONCLUSION

[redacted] is entitled to claim an abandonment loss on some of the [redacted] goodwill. The goodwill relative to [redacted] is fully deductible since all of the [redacted] have been discarded. The goodwill relative to [redacted] and [redacted] is only partially deductible. [redacted] must establish the identifiable intangible asset components of the goodwill acquired with these entities that have a distinct transferable value and prove that these assets were abandoned in fiscal [redacted]. The goodwill associated with the marketing of the [redacted] was not abandoned since [redacted] continues to produce the [redacted] elsewhere.

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FACTS

On [redacted], [redacted], a wholly owned subsidiary of [redacted] purchased the bulk of the assets of a family owned [redacted] operation owned by the [redacted] family in [redacted]. The [redacted] owned three separate businesses. [redacted] and [redacted] operated a manufacturing and [redacted] plant in [redacted] [redacted], a partnership, purchased the [redacted] products from [redacted] and marketed the products to various brokers. [redacted] operated [redacted] used in the production of the [redacted] products. The [redacted] family produced the [redacted] line of [redacted] products, including [redacted] and [redacted] and the [redacted] line of [redacted]. [redacted] products were a low priced [redacted] in the Southeast and Southwest.

Based upon the acquisition agreement, and as modified by a Service examination of this transaction, the goodwill purchased by [redacted] from the [redacted] entities was allocated as follows:

Entity	Goodwill Allocation
[redacted]	$[redacted]
[redacted]	$[redacted]
[redacted]	$[redacted]

The purchase price for the [redacted] businesses was allocated in the following manner:

Entity	Amount
[redacted]	$[redacted]
[redacted]	$[redacted]
[redacted]	$[redacted]

The [redacted] trademark was held by [redacted] and was allocated a purchase price of $[redacted] in this acquisition.

After [redacted] was acquired, [redacted] manufactured [redacted] and [redacted] products at the [redacted] plant until [redacted] of [redacted] when [redacted] was merged into [redacted]. In [redacted] of [redacted] transferred the [redacted] trademark to another wholly owned subsidiary. At that time the trademark was valued at $[redacted] with $[redacted] allocated to [redacted] and $[redacted] to the [redacted]

The [redacted] plant continued to operate until [redacted], when it was closed by [redacted]. Some of the [redacted] tangible assets were transferred to other plants owned by [redacted]. In [redacted] of [redacted], [redacted] sold a portion of the plant to [redacted] for $[redacted] and retained him to lease or sell the rest of the plant. [redacted] continued to produce [redacted] at its other plants until [redacted], when the trademark for the [redacted] was [redacted] licensed to an unrelated entity, [redacted], for [redacted] years for a one time fee of $[redacted]. [redacted] was also given an exclusive, irrevocable option to purchase the trademark for $[redacted] after [redacted] years. If this option were exercised, [redacted] was required to grant [redacted] an exclusive, perpetual license to use the trademark in connection with the manufacture and sale of [redacted]. This license required a payment of $[redacted] when the option was exercised. [redacted] also acquired other assets used in the production of certain [redacted] products on [redacted].

Although [redacted] sold the [redacted] business of [redacted] to [redacted], it retained the [redacted] trademark rights with respect to [redacted] and continues to manufacture and sell the [redacted] for sale under the [redacted] name. These sales approximate $[redacted] per year.

[redacted] claimed a loss for the taxable year ended [redacted], in the amount of $[redacted] relative to the abandonment of the goodwill associated with three [redacted] acquisitions in [redacted]. The revenue agent has questioned whether this abandonment loss should be allowed.

LEGAL DISCUSSION

I.R.C. § 165(a) allows a deduction for any loss sustained during the taxable year and not compensated by insurance or otherwise. Treas. Reg. § 1.165-2 provides that a loss incurred in a business or in a transaction entered into for profit and arising from the sudden termination of the usefulness in such business of any nondepreciable property, in a case where such business or transaction is discontinued or where such property is permanently discarded from use therein, shall be allowed as a deduction under section 165(a) for the taxable year in which the loss is actually sustained. Abandonment of an asset is defined as a permanent disposition by the taxpayer of an asset never to be used again nor retrieved for sale, lease, exchange, or other disposition. Treas. Reg. § 1.167(a)-8. Abandonment is a question of fact and requires proof of an intent to abandon and an act of abandonment.

Goodwill is generally an advantage or benefit which is acquired by a business beyond the mere value of its capital, stock, funds, or other property employed in the business. For tax purposes, goodwill is an intangible asset, or group of intangibles assets, associated with the going concern value of the business. Solitron Devices, Inc. v. Commissioner, 80 T.C. 1, 18 (1983). The loss from the abandonment of purchased goodwill is deductible under section 165(a). See Rev. Rul. 57-503, 1957- 1 C.B. 139. The abandonment of even a component of goodwill which is a clearly identifiable and severable asset entitles a taxpayer to a loss deduction under section 165(a). Massey-Ferguson, Inc. v. Commissioner, 59 T.C. 220, 225 (1972). Goodwill can be severed into its constituent parts and the intangible assets surrendered piecemeal if the owner can prove their existence, permanent abandonment, no favorable prior tax treatment, their adjusted value, abandonment in the proper year, and that the intangible assets were not acquired as a mere incident to a composite transaction. Kraft Inc. v. United States, 94-1 USTC ¶ 50,080 (Ct.Cl. 1994).

[redacted] asserts that it is entitled to deduct the cost of the goodwill acquired in connection with the purchase of the [redacted] operations in [redacted]. [redacted] contends that the goodwill relative to [redacted] was totally abandoned because the [redacted] manufacturing and [redacted] plant was closed in [redacted] when a portion of the plant was sold and the remainder listed for sale or lease. [redacted] goodwill was allegedly completely abandoned since the trademark was exclusively licensed to [redacted] with an option to purchase granted and the assets used to produce the [redacted] were sold to [redacted] as well. Finally, [redacted]'s goodwill was abandoned when the last of its [redacted] was disposed of in fiscal [redacted]. Thus, [redacted] claims entitlement to a full $[redacted] abandonment loss for the taxable year ended [redacted], relative to the [redacted] operations.

The deductibility of the abandonment of goodwill depends on the fact of abandonment and the adjusted basis in each component part of goodwill. Even if a taxpayer cannot establish the precise amount of the basis in the abandoned goodwill or component of goodwill, the courts will attempt to determine the amount of the deductible loss rather than disallow all of the claimed deduction. For example, in Rudd v. Commissioner, 79 T.C. 225 (1982), the Tax Court allowed a portion of the goodwill claimed to have been abandoned by the taxpayer. The amount of the allowable deduction for each intangible asset included in goodwill can be determined by multiplying the total adjusted basis for all intangibles by the ratio of the fair market value of each intangible asset to the fair market value of all such intangible assets.

Continuance of a portion of a business does not prevent the recognition of an abandonment loss with regard to an intangible asset which is shown to have a reasonably ascertainable value and which is connected with the discontinued portion of the business. Parmelee Transportation Co. v. United States, 351 F.2d 619 (Ct.Cl. 1965); Metropolitan Laundry Co. v. United States, 100 F. Supp. 803 (N.D. Cal. 1951). The fact that tangible assets are sold also does not automatically mean that a deduction for abandonment of goodwill cannot be taken. If the sale occurred after the owner abandoned the business, an abandonment loss can still be claimed. Whether the taxpayer chose to sell or dispose of tangible assets is of no consequence to its entitlement to a deduction for abandonment of intangible assets. A subsequent lease of the assets or other disposition would be equally as immaterial to the abandonment loss issue. Kraft Inc. v. United States, 94-1 USTC ¶ 50,080 (Ct.Cl. 1994). Even a lease of the operating assets of a business to a related corporation did not bar an abandonment loss where it was clear that there was no realistic prospect of the taxpayer re-entering the business once the lease had expired. Solar Nitrogen Chemicals, Inc. v. Commissioner, T.C. Memo 1978-486.

Applying the aforementioned legal principles to the [redacted] facts, [redacted] is entitled to claim an abandonment loss on the goodwill purchased from the [redacted] companies but not in the total amount asserted by the taxpayer. Clearly, the goodwill of [redacted] was fully abandoned in fiscal [redacted] since the last of the [redacted] was discarded.[1] With respect to the [redacted] and [redacted] goodwill, there does not appear to be a total abandonment of goodwill. Only the abandonment of a component of goodwill which is a **clearly identifiable and severable asset** entitles the taxpayer to a loss under section 165(a). Massey-Ferguson, Inc., 59 T.C. at 225.

Although the [redacted] plant was closed and the tangible assets partially sold, [redacted] never abandoned the [redacted] goodwill with respect to the [redacted]. [redacted] continues to produce [redacted] even today. [redacted] would be entitled to deduct the going concern value of the [redacted] plant which was abandoned in [redacted] when the plant was shut down. But [redacted] cannot claim an abandonment loss on other intangible assets making up the goodwill unless it can identify each intangible asset, prove the asset has a distinct transferable value as required in Metropolitan Laundry, 100 F.Supp. at 806, and establish that the intangible asset has been abandoned. The goodwill allocable to the marketing of the [redacted] should be excluded from the abandonment loss since that goodwill has not been

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[1]We assume that the [redacted] were not sold or leased which would **not** give rise to an abandonment loss. The [redacted] must be otherwise discarded.

abandoned. The various component parts of the goodwill acquired from [redacted] and [redacted] must be separately identified and isolated. We suspect that this demarcation will be difficult to make however. Only after this analysis occurs can you then determine what part of the [redacted] and [redacted] goodwill has been abandoned and is thus deductible. [redacted] must therefore provide you with such an analysis of the [redacted] goodwill components as of [redacted].

We are closing our file on this matter. If you have any questions, please call Attorney Edward J. Laubach, Jr. at 412-644-3443.

/s/

EDWARD F. PEDUZZI, JR.
Associate District Counsel